UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v. 23 CV 5326 (LAK)

LEGEND VENTURE PARTNERS, LLC,

Defendant.

Oral Argument
(via Microsoft Teams)

New York, N.Y.
June 27, 2023
3:00 p.m.

Before:

HON. LEWIS A. KAPLAN,

District Judge

APPEARANCES

DANIEL LOSS
LEE A. GREENWOOD
ANTONIA M. APPS
Attorneys for Plaintiff

CLARK SMITH VILLAZOR LLP
Attorneys for Defendant
BY: PATRICK J. SMITH
SELBIE L. JASON

(Case called)

THE COURT: Good afternoon, everybody. Did you just change jobs, Mr. Loss?

MR. LOSS: I did, your Honor.

THE COURT: I figured that.

It's the SEC's nickel, so why don't you go ahead, Mr. Loss. I think the area of dispute is pretty confined at this point.

MR. LOSS: That's correct, your Honor.

The commission is here today on its application for applicable relief pending a final disposition of this action.

The disputed issues, your Honor, involve the appointment of a receiver, as well as the commission's application for an order directing Legend to provide a verified accounting.

The defendant Legend has consented, pursuant to its submission of yesterday, to a preliminary injunction, an asset freeze, an anti-litigation injunction, and an order prohibiting Legend from destroying or concealing documents.

Your Honor is correct, the only issues in dispute at this point are the appointment of a receiver and the SEC's request for a verified accounting.

THE COURT: OK. Why don't you address the disputed issues.

MR. LOSS: Yes, your Honor.

The commission believes that the appointment of an independent fiduciary, a receiver, is essential in this matter for the reasons set forth in its moving brief as well its reply.

In particular, Legend and the Legend Funds currently remain in the control of the same principals who are at the helm of the firm and control the funds during the period of the fraud in this matter, during which time approximately $12.8 million of investor assets were siphoned off from investors in the form of undisclosed massive markups to the benefit of the principals and other Legend employees and sales agents.

This emergency, your Honor, is precipitated by the fact that Legend has, as of approximately one week ago, on June 19, informed the commission that it would not consent to the appointment of a receiver, and this is against the backdrop, your Honor, of Legend's possession in its control of millions of dollars worth of pre-IPO shares, purchase agreements for pre-IPO shares that Legend currently is in custody of.

One of the relevant pre-IPO companies, based ON public news reports, is anticipated to IPO in the near future and, in addition, your Honor, there is recent indication, based on the evidence presented with the commission's papers, that Legend is out there again in the market seeking to find investments for the benefit or the supposed benefit of clients. And up until just a couple of days, your Honor, before the commission

brought this emergency action, its website was active continuing to market pre-IPO shares for investors.

The defendant's proposed purported alternative solution of a third-party custodian or distribution agent is simply insufficient based on the facts here. A third-party custodian or distribution agent would not have the powers of a receiver; for example, the ability to marshal assets for the benefit of the estates and the ultimate benefit of investors in the form of potentially clawing back funds that were transferred by Legend to third parties, if that's appropriate.

In addition, based on --

THE COURT: Including, I take it, possibly the principals.

MR. LOSS: That's correct, Judge. That's correct.

In addition, as reflected in the declaration of Ms. Melanie Cyganowski submitted with the SEC's moving papers, there are a number of investors, many investors who have been unable to obtain information about their investments from Legend and, therefore, have turned to Ms. Cyganowski in her role as the receiver in the related StraightPath action to attempt to obtain information.

This too, the ability to serve as a point of contact for investors, is an important duty that a receiver would have that a distribution agent or third-party custodian would simply be ill-equipped and unable to perform.

THE COURT: Thank you.

Mr. Smith, you look mighty familiar.

MR. SMITH: Good afternoon.

THE COURT: How are you.

MR. SMITH: Good, thanks. How are you?

THE COURT: Good. I take it you are representing the defendant.

MR. SMITH: We are. Together with my colleague, Selbie Jason, who is on the line.

THE COURT: I'll hear you.

MR. SMITH: Thank you.

First, your Honor, there is no ongoing fraud. I don't think there is really much dispute about that. There was a voluntary cessation of sales activity back in October of 2022. There has been no solicitation of new investments, no additional receipt of investor funds. I think it's clear from the commission's submission that this economic activity ended as of October of 2022. These several items that they point to as maybe there will be some ongoing -- renewed sales or renewed sales activity do not really add up to an ongoing fraud.

The one issue on the website, they allege that the website was taken down after we received notice that they were going to file this action. I think we submitted in our opposition evidence that the reason the website was turned off was a series of three failed payments because the credit card

was not being funded. I think the website unfairly was just still up as a matter of oversight.

There is a purchase of a lead list, but that's many, many steps short of actual solicitation of investors obtaining any additional money.

THE COURT: What was the point of doing that?

MR. SMITH: My understanding is that the lead generator had sort of a blue-plate special and offered up the leads cheaply. The leads were purchased with maybe some overly optimistic view that maybe sales activity could resume some day where they could be resold at a profit. That's my understanding of why the lead list was purchased.

Since I've been engaged in January, there is a clear understanding that there will be no renewed sales activity while we continue. We have had ongoing continuous discussions, I believe constructive discussions, about potential settlements with the staff, but there would be no renewed sales activity.

In any event, the consent preliminary injunction will address these issues. Your Honor is going to order Legend not to engage in any additional sales activity and anyone who, through Legend, violated that order would risk contempt. That adequately addresses the risk of potential ongoing fraud and it is not a justification for a receiver here.

THE COURT: Isn't there the following problem? If I were to conclude, and, frank to say, quite likely to do so,

that there is a substantial likelihood that the commission is going to prevail here, the fact that the various people with economic interests in your client have 12 or $13 million, that may need to be clawed back in whole or in part. And what's the point of giving them an opportunity to do a better job of hiding it, if they have done that at all, while this percolates the law?

MR. SMITH: The individual members, and there is three, are not parties to this action. Frankly, your Honor, they are our client as well, and we have had ongoing discussions with the SEC on how to settle the SEC's claims, including claims for -- that involves substantial disgorgement. Those discussions are ongoing.

Just think about the practical upshot of a receiver here. If the justification is, put a receiver in place to pursue these claims, there is layering an expense in that would burden any recovery for potential investors.

Where we are really coming from here is, we ought to have a program in place that maximizes the outcome for each Legend investor. So there is seven stocks. Legend investors purchased interest in different funds -- and I don't think there is any dispute about this -- all the Legend investors bought stock at a particular price and Legend went and secured purchase agreements and, in one instance, forward agreements with counterparties, so it neatly ties out. All of the stock

that the Legend investors subscribed to, there is purchase agreements on the other side. So when there is liquidity, these investors will benefit.

A receiver interposed to pursue claims against the principals has to be paid.

THE COURT: That's not the only purpose of a receiver. It's one of them.

MR. SMITH: I'm addressing your Honor's question about, there is $12 million in historical distributions.

If there is going to be fraud claims asserted against these individuals, I think, frankly, the SEC is the one to do it. That would be at no cost and burden to investors. If the receiver were to do it, the costs associated with that litigation would be borne by the receivership estate under the SEC's proposal and would reduce investor recovery. It's just unclear whether those lawsuits will be successful or not.

Your Honor might find a likelihood of success. Even though we are consenting on the preliminary injunction, we outlined the disclosures that were made for the purpose of showing that, well, there may be a little bit more of a horse race here than the SEC is indicating in its papers. In other words, investors were told in several different ways, this was not a straight pass-through at cost.

Take the Triller example. That's the stock that may or may not go public imminently. $15 a share was the level at

which Legend investors purchased. They were told through the PPM and through the operating agreement that there may be markups charged and that Legend was going to go out through affiliates and buy stock at lower levels, would profit from that, and that profit would not be shared with the funds or Legend investors.

THE COURT: What were they told verbally?

MR. SMITH: Unclear. I think the SEC has put in some evidence that there were oral misrepresentations. We would have the written disclosures to be considered against other evidence of oral misrepresentations, and then we'd have arguments about the total mix of information available to investors and whether there in fact was a scheme to defraud misleading statements made.

From the position of what the investors were signing up for, investor expectations were on Triller, sticking with that example, that they were getting Triller at $15 a share. So when there is an IPO on Triller, if there is one, if the stock comes out at $20 a share, they will profit $5 a share. If the stock comes out at $15, they will break even. Those are the basic expectations of investors, and they were put on notice that there might have been some markup up front.

If there are successful claims to claw back those markups, that's just a benefit to investors if that ever comes to pass. But given the economics of the agreement between

Legend and its investors, $15 is the cost basis. If there is liquidity and the stock comes out higher, they will benefit.

They also signed up for an illiquid investment and an uncertain future as to whether or not there would ever be an IPO, so there is substantial risk on these investments.

I am not saying the SEC's allegations about irregularities lack merit, but there will be litigation, particularly if the receiver comes in and sues the principals on a theory of the undisclosed markups. There will be litigation around the adequacy of the disclosure, and the receiver's actions against the individuals may or may not be successful. That's all going to cost money. Every dollar spent on litigation is going to come out of any potential recovery for Legend investors.

It does fairly raise the question, and I think for this reason the SEC's proposal is wholly impractical. There is no liquidity in the entity. There is no near-term liquidity possible. The only way to pay for the cost of this receivership is through either reprogramming the proceeds of an IPO. Let's say Triller goes public in the next couple of weeks and there is potentially millions of dollars of liquidity available. The receiver would grab that liquidity and then make decisions about what to ask the Court and how to spend the money, including on its own fees. That's coming right out of the recovery of Triller investors.

Our proposal is provide that, either through a distribution agent or some other third-party custodian or through Midway directly or through Legend, if your Honor crafts a preliminary injunction that orders them to do this, that Triller investors benefit as soon as possible from liquidity and IPO. If fortunately it goes public, Triller recovers right away. Why would we want to reprogram the IPO proceeds for Triller, which a subset of Legend investors invested in, and pay for an expensive receiver and other costs. It's a bad outcome for Triller investors.

I think the proposals we put forth is you have seven stocks. Each one stands on its own merit. We shouldn't strip investor choice out of the mix here. And Triller investors should benefit from an investor choice. If and when the SEC -- if the case can't be settled with respect to the individual principals, if and when the SEC is successful on its claims and gets disgorgement of the undisclosed markups on the theories they might assert, that would be an additional recovery for Triller investors. But given the economics of the Triller investment, if it goes public next week at $20, I think there is a pretty good argument that Triller investors got the benefit of their bargain and made $5 a share.

With live claims, there is some potential recovery that the SEC might be successful in prosecuting for the undisclosed markups.

What we are really proposing -- let's have a plan that at least gives a shot at making investors whole, not a plan through an expensive receiver that necessarily locks in expensive costs.

THE COURT: Why should your clients, in all the circumstances here, be trusted to get the maximum benefit out of whatever can be realized on these investments rather than saving their own hives, to whatever extent they think they can do that?

MR. SMITH: The order of the Court will take trust out of the equation, number one. If your Honor orders an asset freeze and preliminary injunction and nothing can be done with the purchase agreements other than letting them sit there until there is a liquidity event and the order further provides that we then have to apply to the Court for a permission to distribute proceeds with a schedule -- and this is all tied out, your Honor. The SEC has it and we have it. We have every investor scheduled out, what they purchased, which stock, and at what level.

THE COURT: Who controls the decision, under your proposal, as to whether to sell at any -- as to proceeding with a transaction?

MR. SMITH: Well, a transaction -- so the purchase agreements basically are investments, five of them at least, through a counterparty called Midway Venture Partners, which

runs a series of funds. They either have their own arrangements to get the stock.

But as we put in the declaration of Patrick Powers, a principal of Midway, the agreements are valid, and they stand ready to honor them.

THE COURT: What is Midway and what is their connection to your principals?

MR. SMITH: There is no formal connection. They are the counterparty with Legend on these purchase agreements. So there is an arm's length business relationship with Midway. Legend solicited investor funds, put it in the funds that they managed through my client, Legend Venture Partners, and then Legend negotiated with Midway to invest in their funds that has exposure to Triller and others.

For example, here is how it would work, as I understand it. If Triller goes public, free-trading stock would then be available to Midway. Midway stands ready to take that free-trading stock and, subject to the Court's approval, either distribute it out directly to Legend's investors or to place it in a brokerage account in the name of Legend investors. They are happy to administer that under the Midway proposal.

If Legend is left with any role in this, we would then apply to the Court and basically tell the Court, Triller just went public. I don't have in front of me the number of Triller

shares. Let's say it's 50,000 shares. There is 50,000 free trading shares of Triller.

Your Honor, we have a plan of distribution for the benefit of those Legend investors that invested in Triller, and we want the Court's authority to direct Midway to distribute those shares directly to Triller investors so they get the benefit of their bargain. In that liquidity event, the IPO would take place, and Legend investors who chose Triller would then get the benefit of their bargain.

All claims against the principals remain live. We can either leave the Legend principals in the mix or cut them out entirely through either a distribution arrangement, a distribution agent arrangement, or through Midway, which has, essentially -- Patrick Powers essentially volunteered Midway to do this by opening brokerage accounts.

It is also in his declaration, they don't intend to charge fees, brokerage fees or otherwise, to administer this. They will open up a series of accounts, will run a process where Legend investors are advised to open brokerage accounts at Midway. If and when there is a liquidity event, that's where the stock is going. I think under any of our proposals, Legend's principals never touch the stock, never touch the cash.

Your Honor, for what it's worth, I'm representing Legend and it's very important to my clients and us that Legend

investors are made whole and get the benefit of this bargain I'm talking about here.

It's not a trust issue, your Honor. I think we can correct for trust, or we can completely cut them out and use either the Midway solution or the distribution agent solution.

But really what I'm arguing for here is that we don't build in a layer of costs to have a receiver in place that is necessarily going to hurt investors.

Let's take the Triller example one step further. I think this sort of goes to one of the proposals that the SEC made about one of the benefits of a receiver is some type of equitable distribution plan. That looks a lot like, if there is a Triller IPO, the receiver would then take down the cash proceeds of the IPO and have it in the receivership estate and later would make a determination about some type of distribution plan for the benefit of all Legend investors.

It's not clear to me that that says if Triller was the only liquidity event that Triller investors would get the benefit of their bargain. It sounds like some portion of the Triller proceeds would be reprogrammed to pay back some potential investor loss to other classes of investors.

THE COURT: You are getting ahead of us with that because that would presumably be resolved in an application to approve a distribution plan.

MR. SMITH: Any plan, any future plan that doesn't

keep the classes of investors in each of the seven stocks separate and bring forward the individual investment choice of these investors. Triller investors should benefit from any Triller liquidity event, IPO. Other investors simply need to wait and see what happens.

Look, receivers are expensive. Your Honor has seen the fee applications in StraightPath. I think 3.5 million approximately has been approved with another roughly million dollars -- it's over $4 million in fees. There is no cash in this potential receivership estate to pay anything.

I guess I should note here, your Honor, this not StraightPath. The SEC has marked this a related case. We are happy to have the case before your Honor. But there are no Ponzi allegations. There is no commingling allegations. There is no missing fund allegations.

In fact, I think there is substantial agreement with the SEC that the assets in Legend are these purchase agreements, there is no cash and roughly $12 million of historical distributions to principals, and then other distributions or payments to pay for the unregistered sales force.

We all know where the assets are. A receiver doesn't really need to come in and marshal assets that are already marshaled. We all know where it is. Nonetheless, the receiver is going to run her process and it's just going to cost money

and it has to come from somewhere.

One other potential source is maybe there is some fire sale of the purchase agreements. So Triller is a $15 basis for investors and that money was paid over to Midway. You could sell that purchase agreement at a discount.

I think we are probably all aware that the venture capital market over the last year, year and a half has, in some instances, collapsed. That's one of the reasons there has been no liquidity. But you probably can't sell these purchase agreements at face. If you do a fire sale of the purchase agreements, you're locking in investor losses. The money has to come from somewhere. Maybe it comes from a successful lawsuit against the principals. But, again, there is defenses to that lawsuit, and any recovery from the principals years away. There is no near-term practical solution --

THE COURT: Mr. Smith, are the principals asked, as a condition of going down one of your routes, to escrow all or any of the $12.8 million?

MR. SMITH: They are not. They have liquidity issues themselves. I'm not saying there were not substantial distributions. But we are not prepared to escrow -- the nonparties to this case, they are not prepared to make an escrow deposit to pursue one of these other paths. I suppose it's open for discussion. That specific solution has not been discussed with the SEC.

What they asked for in January, when I was first getting into the case, was, please pay for the receivership, and we respectfully declined to do so that. They came back to us about three weeks ago and said, we are going to seek a receivership. The question of cost was not raised.

We have not discussed with them, and it's probably worth discussing, is there some way to make some type of payment and then go down one of these other paths. I'd have to take that back to the individuals and discuss it with them. I think that would actually benefit investors, because we would leave open the possibility of, again, these investors being made whole if there is any recovery, an IPO.

THE COURT: OK. Let me hear a final word from Mr. Loss.

MR. LOSS: Apologies, your Honor. A technical issue here.

THE COURT: Sounds like E.T. is returning.

MR. LOSS: Apologies, your Honor. One moment.

Your Honor, I have tried to switch the audio. Are you able to hear me now?

THE COURT: Yes.

MR. LOSS: Apologies, your Honor.

Mr. Smith raised a number of different issues, but I think they boil down to two main problems.

One is that Legend is oversimplifying the issues in

terms of what could happen with respect to a distribution agent or custodian. On the other hand, Legend is overstating the expense that is likely to result to investors from a receivership. Let me address both of those things in turn.

First of all, with respect to, why isn't this as simple as simply having the shares of, let's say, Triller go to the investors who purchased series interests in a fund that bought Triller upon a Triller IPO. Why isn't it just that simple. And there are a number of potential reasons, your Honor, as to why that may not be an appropriate solution that is in the best interests of all investors.

We have a situation here where all investors in the Legend Funds were charged massive undisclosed markups. They were all victims of fraud.

Now, the particular size of the markup may have varied. They were all large, but they may have varied based on the particular pre-IPO company at issue. And, in addition, whether or not they got lucky or get lucky in the future and have one particular company end up IPO'g versus another company IPO'g, it is not necessarily the case that whether the investors are lucky or not in that respect or whether they were lied to in terms of being charged a 60 percent markup versus a 100 percent markup, it is not necessarily so clear that the most equitable result here for the benefit of all investors is to simply adopt the distribution agent function that Mr. Smith

has advocated. There are complexities in that regard.

In regard to addressing your Honor's questions about the ability of a receiver to go out and marshal additional assets for the benefit of the estate, a power that obviously a distribution agent or third-party custodian would lack, Mr. Smith said, in effect, and I'm paraphrasing here, but I think he said, in effect, well, the SEC can go out and sue third parties for free. Your Honor, if that were the adequate answer, then it would be an argument to defeat a receiver in every single case where a receiver is appointed.

Now, the fact is, the SEC does have an ongoing continuing investigation. However, there are abilities and potential powers that a receiver has in terms of clawing back assets from third parties who may not even have committed any wrongdoing but who are in possession of receivership property. The receiver has that ability that the SEC may not have, and there may be particular efficiencies in fact for a receiver to marshal assets of the estate in that manner.

I would note in this respect that there is substantial -- although there are differences, to be sure, between StraightPath and Legend -- and in fact many of those differences explain why the cost of a receivership in Legend is anticipated to be substantially less than in StraightPath. I'll elaborate on that in a moment, your Honor.

But while there are these differences between

StraightPath and Legend, there are also many commonalities in terms of the overlap of investors and the overlap of folks who received funds that potentially could be a estate property in either Legend or StraightPath. This stems from the overlapping sales agents between the StraightPath action and in Legend as well.

Let me for a moment, your Honor, now just -- I hinted at it a moment ago, but let me address the concerns that Mr. Smith raised with respect to the expense of the receivership. This case, from a standpoint of what it will cost to have a receiver, is simply not StraightPath. This stems from a number of different factors. Number one, there are fewer, far fewer investors. Number two, there was less money raised. Number three, there were not liquidity events to date that caused additional enormous work for the receiver and costly work for the receiver in a StraightPath action. Those are some of the differences.

When you add to that, your Honor, the fact that if the Court were to consider the appointment of Ms. Cyganowski, the StraightPath receiver in this matter, there would be very significant efficiencies to be gained.

These efficiencies result from numerous facts. They result from the fact that there is 70 percent overlap in investors from a standpoint of the amount of money raised from investors. They result from the overlapping sales agents

involved. The overlap also means -- the overlap, in terms of the investment structure, in terms of the pitch to investors, in terms to the -- in terms of the way these funds were organized and the way these investments were sold, all of that has given the receiver in the StraightPath action, Ms. Cyganowski, an incredible headstart so that she would be able to hit the ground running in this matter.

Related to that, your Honor, there has already been a claims process put in place in the StraightPath matter which could be, the commission anticipates, easily adapted for Legend, particularly when one takes into account the overlapping in investors here who are already familiar with the claims process from StraightPath.

Your Honor, I'm happy to answer any additional questions that the Court has, but I don't want to belabor my response here.

THE COURT: Thank you.

One more question for you, Mr. Smith. That is, assume for the sake of argument that I grant the motion to appoint a receiver. Is there any reason why it shouldn't be retired Judge Cyganowski?

MR. SMITH: Your Honor, other than the expense issues I've been noting, no. And I would note that Mr. Loss did not address near term how any of the costs of the receivership would be funded.

I think that if we asked a Triller investor, do you --

THE COURT: Mr. Smith, I've got to interrupt you because you've had your say, and I just asked you a straightforward question.

I do think it's fair to ask Mr. Loss, in view of your statement, how the commission would propose funding the near-term cost of a receiver.

MR. LOSS: Your Honor, I think a couple of responses to your question.

First is that Ms. Cyganowski has expressed a willingness to take on this matter with the understanding that there is not any near-term liquidity.

Secondly, your Honor, in response to your question, as well as in response to a point that Mr. Smith raised earlier, any of the potential actions to recover additional assets for the benefit of the estate against third parties would be -- in any such actions the receiver would be compensated on a contingency basis.

THE COURT: That's helpful.

Here is what I am going to do.

First of all, I'm obviously granting the preliminary injunction. That's effective as of now.

That contains, does it not, Mr. Loss, the anti-litigation relief you're looking for. It's part of the preliminary injunction, isn't it?

MR. LOSS: Yes, your Honor.

THE COURT: I am going to reserve on the motion to appoint a receiver, except to the extent that if I decide to do it, it will be Ms. Cyganowski for all the reasons that have been indicated.

I will give the defendant, including the principals, until Wednesday to make in writing -- is today Tuesday?

MR. SMITH: Today is Tuesday.

THE COURT: I'll give you until Thursday to make a written proposal to the commission, which is your last best offer on an alternative to a receivership. Obviously, if you work it out with the commission at that point, I'll consider it very carefully. If you don't work it out, the commission will have until next Tuesday to respond to your last best offer and you, Mr. Smith, will have until next Monday to tell me why I should take that rather than grant the receivership.

If you need to adjust these dates in a very modest way, I'm happy to entertain that now. That was off the top of my head. Other than that, it seems to me that's the way I want to go.

MR. SMITH: You're not contemplating a filing with the Court; rather, we should sort of submit directly to the SEC our proposal.

THE COURT: In the first instance.

MR. SMITH: This Thursday we get our proposal in.

They respond to us. That was by the following week, the following Wednesday?

THE COURT: Monday.

MR. SMITH: Monday.

THE COURT: The following Monday.

Then if there is no agreement, you each have 24 hours, with the defense going first and then the commission, as to why I should accept the defense proposal rather than a receiver and why I should not. How is that?

MR. SMITH: Very good, your Honor.

MR. LOSS: Your Honor, understood.

Just with respect to the scheduling for the submission to the Court, I believe your Honor mentioned 24 hours following next Monday, which would be the 4th of July. Would your Honor have any objection --

THE COURT: That's not very good.

MR. LOSS: -- putting that off until July 5?

THE COURT: Sure.

MR. LOSS: The commission would also be prepared, if you would like, your Honor, to submit a proposed preliminary injunction order following the conclusion of today's hearing.

THE COURT: Yes. In all of the circumstances, it ought to be agreed as to form by Mr. Smith, right?

MR. SMITH: Yes, please.

THE COURT: Work it out. Get it to me. I don't see

why you can't do that tomorrow. Can you get that done tomorrow?

MR. LOSS: We can, your Honor, and we will do that.

THE COURT: Good. Thank you. This was a very helpful argument.

Good afternoon.

(Adjourned)